As drawn from the Fifth Circuit's opinion, the facts are as follows:

January 9, 2003: FTC filed a complaint in the Western District of Texas (Waco Division) against the Utah-based defendants Assail Inc. ("Assail") and Kyle Kimoto. Neither Valdine Management Co. ("Valdine") or Alliance Solutions, Inc. ("Alliance") were named or otherwise identified.

The district court entered an *ex parte* temporary restraining order at the FTC's request that, *inter alia*, froze the defendants' assets. The order further made it binding on the defendants and "their . . . attorneys . . . and all other persons or entities in active concert or participation with [the defendants] who receive actual notice of this Order. . . ."

The court appointed Robb Evans & Associates, LLC ("REA") as receiver.

January 15, 2003: REA raided and took control of Assail's office in St. George, Utah, as well as Valdine's offices, which were located in the same office complex. (Also according to the Fifth Circuit's opinion, the record suggests that REA made "a few . . . mistakes when it initially raided Assail's offices," including raiding the wrong offices).

January 16, 2003: Kimoto retained Draskovich.

January 17, 2003:	Alliance paid a $200,000 retainer to Draskovich. Alliance was not named in the TRO.
January 20, 2003:	Valdine and Steven Henriksen, Valdine's president, secretary, treasurer, sole shareholder, sole employee and sole bank account signatory, retained Dean Kajioka.
January 21-22, 2003:	Henriksen withdrew $60,000 from Valdine's account to pay Kajioka's retainer. Valdine was not named in the TRO.
January 21, 2003:	Valdine paid an additional $10,000 to Draskovich.
February 4, 2003:	Preliminary injunction was entered with essentially the same terms as the TRO.
September 22, 2003:	Kimoto, Assail and the FTC entered a stipulated judgment of $106,000,000. Such judgment contained a provision allowing the defendants' attorneys to apply for fees from the receivership estate.
October 2, 2003:	Draskovich applied for fees.

From these facts, the Fifth Circuit concluded that a duty of inquiry was triggered as of January 20, 2003. In particular, the Fifth Circuit found that Draskovich knew on that date that his client was accused of perpetrating telemarketing fraud, that all his assets were frozen, and that unrelated third parties would pay his fees. Appendix A, p. 15a-16a.

Accordingly, says the Fifth Circuit, "[t]hese facts should have raised Draskovich's suspicions." *Id.* However, if that is true, then *anytime* a lawyer's potential client has had his assets frozen then a duty of inquiry is triggered. The trouble with this analysis is that, if followed, a defense attorney will automatically be placed on a duty of inquiry in fairly common fact situations. Setting aside, for now, the cumbersome "audit" duty the court also imposes, the Fifth Circuits overly sensitive trigger necessarily conflicts with *Bressman* and *Bell & Beckwith*.

The most telling indicator of a circuit conflict is that the Fifth Circuit's analysis, if applied by the Third and Sixth Circuits, would yield different results. Indeed, consider first the Fifth Circuit's finding in the context of the *Bressman* facts. There, the two firms involved knew that debtor's assets were part of a bankruptcy estate and under trustee control. *Id.* at 233. They also knew that the client was accused of securities fraud by the SEC. *Id.* Finally, they knew that their fees would have to be paid by a separate source. *Id.* at 233 and 238. According to the Fifth Circuit, this triggers the duty of inquiry/audit, and assumes knowledge of all the facts an audit would reveal. The Third Circuit, however, held otherwise, holding that no duty of inquiry was triggered, despite the fact that the bankruptcy trustee informed the firms, in writing, that it suspected the firm's fees were improperly funded before the fees were paid. *Id.* at 238-39.

Moreover, though the result in *Bell & Beckwith* would be the same, the Third Circuit's analysis would have never occurred. As with *Bressman*, the defense attorney knew before being paid that his client had been accused of perpetrating a fraud against his employer brokerage firm. He also knew that the brokerage firm's assets were subject to a receivership. *Id.* at 846-47. Such facts, however, did not trigger a duty under the "nature of the property" analysis followed there. As that opinion shows, the Sixth Circuit's

reasoning was based on the fact that the nature of the property paid to defense counsel established its origin in entities the client had admitted defrauding. *Id.* at 849. Under the Fifth Circuit's opinion, such analysis would not even be necessary. The mere facts that the lawyer knew the accusations against his client and that his assets were subject to a receiver's control would trigger a duty to audit and, ultimately, forfeit payment of his fees.

Moreover, consider another common fact pattern. A client is served with a complaint in which he is accused of wrongdoing, including fraud. Included in the complaint is a request for a constructive trust, claiming that all the funds the defendant has gained through his business were garnered through fraud, and are held in trust for the plaintiff. Though not an asset freeze, it is clear that the potential client is claimed to hold funds that do not belong to him, and instead, in trust for another. Thus, the attorney knows the client is accused of fraudulently conducting his business, that the funds received in his business allegedly belong to others, and that the only way the client can pay attorneys' fees without employing supposedly tainted funds is to use a separate source for payment. Under current Fifth Circuit authority, these facts give rise to a duty by the defense attorney to audit the source of his payment or run the risk of being sued for what he was paid.

This "trigger of inquiry" issue cannot be departed without addressing another troubling aspect of the opinion; that is, the adversarial role the Fifth Circuit necessarily creates between the defense attorney and his client. According to that court, the very fact that the client has been accused of fraud should make the attorney suspect an impropriety with regard to his fee payment. In particular, that court found that "[t]rusting [the client's] truthfulness unconditionally was especially unreasonable considering that he was accused of fraud, an allegation going directly to his honesty." *Petitioner's*

App. A, p. 16a. This statement follows a brief analysis of law governing 21 U.S.C § 853. Section 853, which is not applicable here, vests ownership of assets gained through certain criminal enterprises in the federal government. However, the Fifth Circuit used this analysis to suggest that *anytime* a client is accused of fraud, his attorney should distrust his representations. In essence, the *law* should presume the client not guilty, but his lawyer should not.

This is troubling because it creates a precedent requiring a lawyer to be suspicious of his client's integrity knowing nothing more than the allegations made against him. When a defense lawyer first meets with a client to discuss representation, that client is there because he is accused of wrongdoing. Not to be trite, but it is not a social call. If the fact that a client is accused of acting improperly or illegally forces an attorney to question his client's character, then his representation of that client is chilled before it begins. That is not to say that circumstances cannot arise that may require an attorney to do just that. But, the fact that allegations have been made and an *ex parte* ordered entered should not force counsel to question his client's truthfulness automatically.

II. The Fifth Circuit's Opinion Is Also Unreasonable Because, Following the Near Automatic Triggering of the Duty of Inquiry, the Court Has Turned that Duty of Inquiry into a Duty to Audit. Such Is Unworkable Because to Require Defense Counsel to "Audit" Mandates Defense Counsel to First Perform a Formal Investigation of the Client's Books of Account before Providing Legal Services, thereby Placing the Client/ Defendant's Immediate Interests and Needs at Risk.

According to the Fifth Circuit, an accusation coupled with an *ex parte* asset freeze automatically forces the attorney to conduct an audit into the source of a retainer necessarily funded by a third-party. Thus, in addition to performing the numerous functions necessarily attendant to representing a client already the subject of extraordinary relief, the Fifth Circuit finds it reasonable as a matter of law to subject counsel and client to a further auditing duty. The TADC contends that such is an unreasonable burden under this, or any, circumstance.

As defined by Websters Dictionary, "audit" means as follows:

> **1 a:** a formal or official investigation and verification of books of account (as for reporting on the financial condition of a business at a given date or on the results of its operations for a given period) **b:** a methodical examination and review of a situation or condition (as within a business enterprise) concluding with a detailed report of findings: a rendering and settling of accounts **2:** the final report following a formal examination of books of accounts; an account as adjusted by auditors: final statement of account. . . .

WEBSTERS NEW THIRD INTERNATIONAL DICTIONARY, p. 143 (Merriam-Webster 1986). Inasmuch as the Fifth Circuit failed

to provide any different meaning, practitioners are left with such a common and ordinary usage to determine what the dictates of the opinion require. Thus, as matters now rest, if a practitioner is confronted with a client whose assets are frozen and in desperate need, but with a third-party willing to fund defense costs, then the lawyer must first perform an audit. Otherwise, the attorney begins representation without any assurance he will be compensated. According to the "audit" definition, this includes a formal investigation or examination of books of account to determine the source of any funds used to pay him. This, of course, is a lengthy and expensive process.

The TADC respectfully contends that adding an audit to the already daunting tasks facing defense attorneys in such circumstances is unreasonable. Typically, once the accused informs his newly-retained counsel of a restraining order and the upcoming preliminary injunction hearing, the attorney is already faced with performing numerous tasks to fulfill his role as a zealous advocate. Excluding any special circumstances, the attorney duties include timely answering, requesting and performing expedited discovery, conducting legal research, writing briefs, and preparing for an evidentiary hearing concerning the merits of the asset freeze. Now, on top of that, the attorney is further required to undertake an "official investigation" or "verification of books of account" to determine the source of his fees. The Fifth Circuit demands this audit despite his client's assurances (as in this case) that the funds are not tainted and the paying third party has not been specifically named in the asset freezing order.

As the underlying facts illustrate, performing an investigation of books of account takes no small amount of time. The receiver here seized the defendants' (and other) offices on January 15, 2003. *Petition*, App. A, 4a. Nonetheless, he made no demand for the fees paid until June 2, 2003. *Id.* at 6a-7a. Thus, the receiver, who held access to and control over the defendant's offices and books, required

four and one-half months to conclude the fee source was tainted. But, it is now expected that the defendant's counsel, whose client has been stripped of access to much of the books of account, should conduct an audit in a necessarily expedited manner, and further require the client (whose guilt or innocence remains in question) to wait in limbo until the process is concluded before knowing whether he has representation.

III. The Fifth Circuit's Opinion Ignores Concerns Associated with Presuming a Defendant Has Committed Wrongdoing Prior to a Judgment, and with Giving the Plaintiff/Prosecution Financial Control over the Defendant's Ability to Defend Himself from His Accuser's Allegations.

A. Federal Savings & Loan Insurance Corp. v. Dixon.

The Fifth Circuit previously addressed, in what circumstances, frozen assets should be used to pay defense fees in *Federal Savings & Loan Insurance Corp. v. Dixon*, 835 F.2d 554 (5th Cir. 1987). The facts of *Dixon* were, unfortunately, not unique in the 1980s. After seizing control of a certain savings and loan, the FSLIC discovered that reality did not coincide with the assets shown on its books; and further, that the savings and loan had paid allegedly exorbitant salaries and bonuses to several officers and directors. *Id.* at 556-57. The FSLIC then sued the officers and directors, and at the outset gained an order (and later, preliminary injunction), restraining the individual defendants from using assets garnered from the savings and loan. *Id.* However, the court did allow the defendants to use $3500 per month the pay personal expenses. *Id.* at 557. Nothing in the opinion suggests a criminal investigation was being pursued.

In addressing the issue before it, the Fifth Circuit made two unavoidable observations: (1) that the defendants were simply accused of wrongdoing at the time the limiting injunction was entered, and that the court could not "assume the wrongdoing before judgment in order to remove the defendants' ability to defend themselves"; and (2) the very "basis of our adversary system is threatened when one party gains control of the other party's defense. . . .". *Id.* at 565. Having concluded that even were an attorney to charge $100 an hour, and further assuming the entire $3500 were available for such fees, the most that the defendants could receive was 35 hours of attorney time a month — "not a significant amount in major litigation." *Id.* at 564. Thus, the Fifth Circuit concluded that if the defendant can show he cannot pay for a defense without using frozen assets, then the court should allow such assets to be used. To offset any fear of using the guise of fees to mask other uses, such requests could be tempered by the opposing party's ability to show the likelihood of an impropriety resulting from the defendant's request. *Id.* at 565. In essence, the court found it necessary to balance the defendant's right to defend himself against the risk such right may be used to conceal an inappropriate bilking of the protected assets. *See also United States v. Thier*, 801 F.2d 1463, 1474-75 (5th Cir. 1986).

B. The Fifth Circuit's Underlying Opinion Fails to Balance the Defendant's Need to Defend Himself Against the Need to Protect Assets.

As noted, the court in *Dixon* expressed concern that, even in civil actions brought by a government agency (or pseudo-agency such as the FSLIC), the defendant's right to counsel must be considered, so that even if only frozen assets are available to fund defense costs, such assets should be made available with court supervision. Here, however, such issue was entirely ignored. The Fifth Circuit's opinion establishes that the district court was presented with whether the defense counsel should be entitled to keep some or all of their compensation,

even if indirectly paid from frozen assets. In particular, the court noted that the agreed judgment allowed the defense counsel an opportunity to apply for fees against the receivership estate. *Petition*, App. A, pp. 4a-5a. Further, Draskovich filed such an application on October 2, 2003 to which the FTC responded on October 22, 2003 and which the district denied on November 2, 2003. *Id.* However, in its opinion, the Fifth Circuit never addressed whether the receivership estate should be required to fund some portion of the attorneys' fees.

If this Court believes the *Dixon* opinion is correct, then the Fifth Circuit's opinion here is necessarily wrong. As above noted, the court in *Dixon* found that it set a dangerous precedent to assume wrongdoing before judgment, and then strip the defendant of its ability to employ counsel based on that assumption. Yet this is exactly what has happened in the underlying case.

Admittedly, the underlying facts indicate that the defendants stipulated to committing wrongdoing through an agreed judgment entered in September 2003. Indeed, this played no small part of the Fifth Circuit's opinion:

> The instant case did not involve criminal charges, although it bears mentioning that both lawyers were retained for potential criminal representation. Even though criminal charges apparently did not materialize, it is clear that [the client] committed multiple, egregious violations of the FTCA. Further, the fees in question were derived from Kimoto's fraudulent scheme. Thus, it seems entirely appropriate to apply to the instant case this general ethical obligation to "audit" a client before accepting potentially tainted fees.

Petition, App. A, p. 12a. The problem with this reasoning lies in the fact that, as of January 20, 2003, there was no

agreed judgment, there were no stipulated facts, and there was no reference to Valdine or Alliance in any pending order. Thus, the Fifth Circuit applied post-judgment circumstances to find what defense counsel should have known within days of being approached for representation. Because of this, authority now exists for the propositions that: (1) a lawyer (and trial court's) should presume a client's guilt before it is ever established; and (2) a client who has no other recourse but to use potentially tainted funds for a defense should be entirely disallowed from doing so, thereby resting control over his defense entirely in his accuser's hands. Both of these are directly at odds with the Fifth Circuit's concerns in *Dixon*, and run counter to the notion that a defendant is innocent till proven otherwise, and that a plaintiff bears the burden of disproving such innocence.

Finally, it is noteworthy that the decision may affect counsel's ability to advise his client objectively as to when to settle and when to fight. This question is highlighted by the facts of the underlying case. Indeed, the defense counsel may have been better off to continue fighting the lawsuit, knowing that the only way to be paid is through the hope of complete absolution, rather than, less than nine months after the case began, entering a stipulated judgment that ends the matter.

CONCLUSION

The Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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